COVID-19: An update since our last note

This note summarises market movements over the past six months, and what to expect going forward.

Investing in a post-COVID world

Despite the uncertainty about the domestic and global economy, financial markets have staged a rapid recovery since the COVID-19 pandemic triggered a severe sell-off in February and March this year. The fiscal and monetary stimulus of economies contributed to the improved sentiment in markets since April, but the question is to what extent this can be sustained. We are also currently faced with a variety of problems in South Africa that will not disappear overnight.

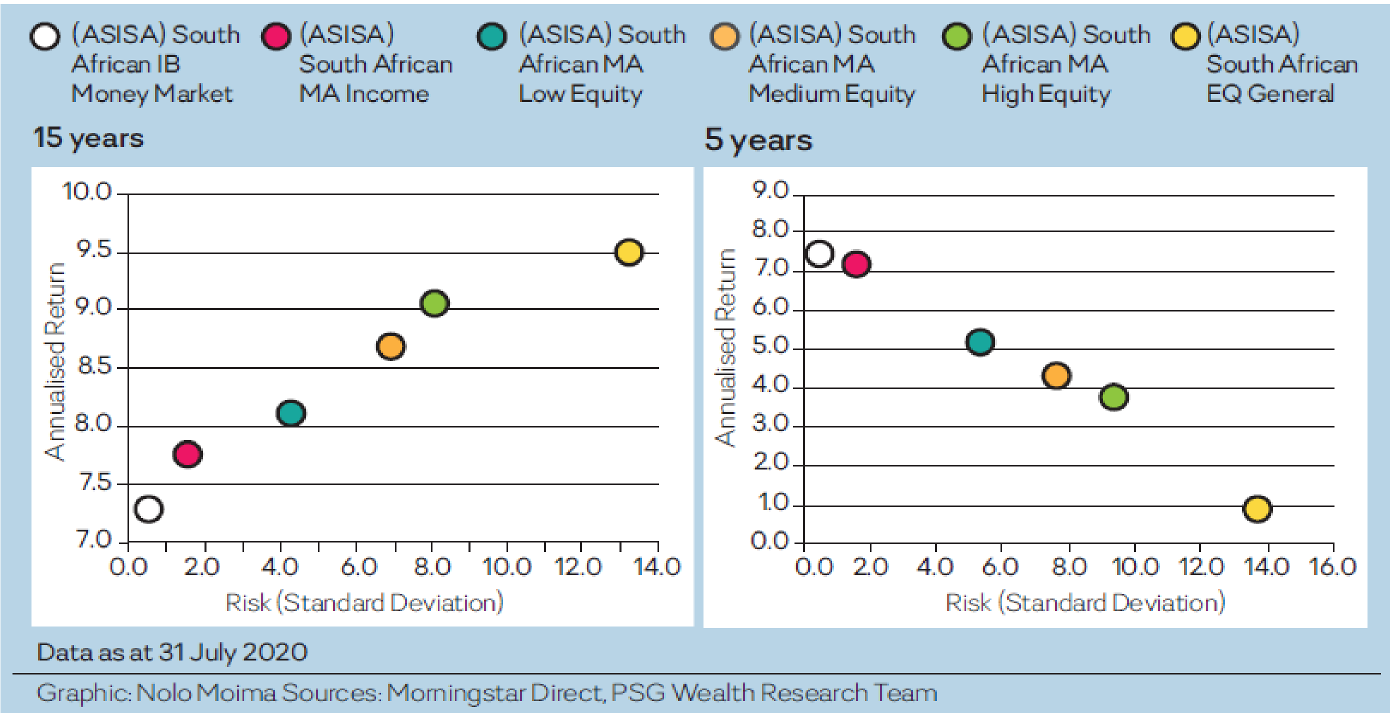
Going global or staying local

In addition to challenges at home, the global economy is also plagued with substantial uncertainties. Global economic prospects hinge on COVID-19 timelines. It is still uncertain when we will get a vaccine, produce the quantities required, and make it available to masses of people. We also wonder what will happen to all the debt that has been created on government balance sheets around the globe? And what surprises will the US presidential election bring?

Markets over the past few years

The past five years delivered disappointing real returns, mostly due to an abnormal period of asset class returns in South Africa. This period saw conservative assets, specifically cash, significantly outperform growth assets like equities and listed property. Traditionally one expects long-term riskier assets, specifically equity, to substantially outperform cash. To illustrate the anomaly of the past five years, the graphs below indicate the relationship of the major domestic ASISA sectors over the past 15 and five-year periods. Graph 1 represents the past 15 years and highlights the expected outcome: the further out you go on the risk spectrum, the bigger the reward in the form of higher returns.

The risk-return spectrum for ASISA asset class returns over the past 15 and 5 years



Sources: Morningstar Direct, PSG Wealth research team

Is local investing still relevant?

South Africans are legitimately frustrated with the situation. Investors and citizens have been through a period that has tested us on every conceivable level. Considering the facts, it does seem that the government has been able to make more progress in 18 months, than what was achieved in the preceding 10 years. Regrettably, it does not show in our economic growth numbers, and that is going to take some more time. The expectation is for the economy to stage a recovery from a low base next year, and then to build momentum from there. In the meantime, we are offered excellent investment entry points into great South African businesses. Bond yields are also offering returns that will comfortably beat inflation. We believe the next five years will look materially different from the preceding five – and in this environment investors need to be aware of the consequences of being either too conservatively positioned, or not being sufficiently diversified.

Contrary to popular believe, investment prospects in South Africa are remarkably attractive. Superior returns are not on the table in an environment where the outlook is clear. The best investments are made during challenging periods, when valuations are cheap, and uncertainty is high. In addition, our clients still benefit from offshore diversification as well. We maintain very well diversified portfolios and mitigate risk while seeking disproportionate upside potential.

Perspective in times of crisis is critical

In times like these we offer our clients the two most valuable pieces of artillery – the ability to guide them rationally, and to see the bigger picture. These are the greatest tools an investor can hope for in an environment that has beaten them down and tested them.

We too often see investors obsess over fund performance numbers as published by a wide variety of mainstream media and commercial publications. Yet, there seems to be too little cognisance of the fact that, even if you were to find the best fund portfolio, odds are the average investors' experience was, or is, and probably forever will be, very different. That is because investing is a process that is susceptible to emotional interference. Investor's rarely remain unswayed by news or market movement, and simply remain invested. Instead, they can panic, or make poor decisions, for whatever reason. That means that although the fund manager is performing well, the investors are not using the product correctly, and therefore not extracting full value.

This is exactly where a good financial adviser can be very valuable. In tough times an adviser should guide you and advise you how to not make mistakes. To think rationally about your investments, your goals, and how to achieve them. Typical mistakes avoided through this process are often expensive mistakes we see in the direct client or non-advised space – following performance, or buying high and selling low.

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